IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

~~No. 1082~~ 70-52

UNITED STATES OF AMERICA,
Petitioner,

vs.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT, MISSISSIPPI CHEMICAL CORPORATION, ET AL.

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QUESTION PRESENTED

Whether payments of "interest override" to the New Orleans Bank for Cooperatives (required to be made quarterly at the rate of 15 percent of the contractual interest upon loans) are deductible by the taxpayers, in whole or in part, as interest or as ordinary and necessary business expense, or whether such payments are nondeductible as money required to be paid for purchase of an income-producing entity (Class C stock) at fair market value.

STATEMENT OF THE CASE

A.

The Federal Farm Credit System and the Banks for Cooperatives

This statement corrects and supplements the "Statement of the Case" appearing in the brief for the petitioner. Although such brief refers to the history of the Agricultural Marketing Act of 1929, c. 24, 46 Stat. 11 (12 U.S.C. 1964 ed., Secs. 1141-1141j), the Farm Credit Act of 1933, c. 98, 48 Stat. 257 (12 U.S.C. 1964 ed., Secs. 1131c-1138f, and U.S.C., Sec. 1011), and the Farm Credit Act of 1955, c. 785, 69 Stat. 655 (12 U.S.C., Secs. 1134-1138) with the numerous amendments thereof, it presents an erroneous conclusion concerning the nature of the entities created by the Act.

The Banks for Cooperatives, the Production Credit Associations and the Federal Land Banks are a part of the Farm Credit Administration. The nature of a district Bank for Cooperatives, the role of Federal funds made available for which Class A stock was issued and the relationship of the issuance of Class C stock of the district Bank for Cooperatives has been totally misconceived by the petitioner. The basic control of the Federal Farm Credit Board over all entities within the Farm Credit Administration (including the Central Bank for Cooperatives, the Regional Farm Credit Boards and the Banks for Cooperatives) is stated in Title 12 U.S.C. 636b:

> § 636b. Farm Credit Administration as independent agency; location; utilization of services; control
>
> *The Farm Credit Administration shall be an independent agency in the executive branch of the Government.* It shall be housed in the Department of Agriculture in

> the District of Columbia, and it may, with the consent of the Secretary of Agriculture, utilize the services and facilities of the Department of Agriculture. *The Federal Farm Credit Board, hereinafter provided for, shall have direction, supervision, and control of the Farm Credit Administration and of its operations and functions,* as provided in sections 636a-636h, 640b, 640d, 903, 1131c(e), 1131e-1, 1134d, and 1134-1 of this title. Aug. 6, 1953, c. 335, § 3, 67 Stat. 390.

The twelve Farm Credit Districts were created by Title 12 U.S.C. 640a. Within each district there is a Federal Land Bank, a Production Credit Association, and a Bank for Cooperatives. These include the New Orleans Bank for Cooperatives, as well as the St. Louis Bank for Cooperatives and the Springfield Bank for Cooperatives, which are mentioned later. The Federal Farm Credit Board controls the district Banks for Cooperatives as stated in Title 12 U.S.C. 1134c:

> § 1134c. Lending power; custodians of collateral—*Subject to such terms and conditions as may be prescribed by the Farm Credit Administration, the banks for cooperatives are authorized* (a) to make loans to cooperative associations as defined in the Agricultural Marketing Act, as amended, ...

The Stipulation filed in these cases states (A 104):

> 49. The New Orleans Bank for Cooperatives, at all times material herein, was operated under the supervision of the Farm Credit Administration, an independent agency in the executive branch of the Government. The Farm Credit Administration was authorized by law to make rules and regulations under the Farm Credit Act of 1933 and Acts amendatory thereto. (12 U.S.C., Section 665.) Attached hereto as Exhibit 17 is an official publication of the Farm Credit Administration entitled Manual for Banks for Cooperatives (including copies of all amendments thereto through June 30, 1963), which includes *regulations of*

the Farm Credit Administration governing the operations of banks for cooperatives; certain statements of policy relating to their activities, various basic forms and procedures; and selected informational material assembled for convenient reference.

Thus the parallel which the petitioner attempts to draw with private banking institutions and business corporations and the purchase and ownership of stock therein is wholly incorrect and misleading.

In a publication issued by the Farm Credit Administration[1] the control of the local business of each Regional Bank for Cooperatives is described as follows:

> Located at the same point in each of the 12 Farm Credit Districts are a Federal Land Bank and Federal Intermediate Credit Bank, as well as a Bank for Cooperatives.
>
> *The cooperatives owning stock in a district Bank elect two of the seven members of the district Farm Credit Board which serves as a board of directors* for all three Farm Credit Banks in the district. The Production Credit Associations elect two members and the Federal Land Bank Associations elect two members to each district board. The seventh member is appointed by the Governor of the Farm Credit Administration, with the advice and consent of the Federal Farm Credit Board.

However, the cooperatives owning stock in a district bank are originally permitted to elect only one member of the seven-man board, this being increased to two members when a certain portion of the government funds have been returned by the retirement of Class A stock. *Each holder*

1. The publication "Banks for Cooperatives . . . how they Operate" issued by the Farm Credit Administration as Circular 40 on January 1, 1967, was introduced as Exhibit 18-B to the Stipulation filed herein and is described in paragraph 50 thereof (A 105, 179; R 246).

of "Class C stock" in the New Orleans Bank for Cooperatives *had the right to cast only one vote for only one member* of the Regional Farm Credit Board during the years 1958 through 1963, the years here involved (A 226). This limitation applied regardless of the amount of "Class C stock" owned.

B.

Nature of the Credits Upon the Books of the Bank for Cooperatives Designated As "Class C Stock"

There are four categories of credits which have been entered upon the books of the New Orleans Bank for Cooperatives designated as "Class C stock":

(1) *An initial share of stock* which is purchased by a cooperative when it makes its first loan and for which it is required to pay $100. *The eligibility of the cooperative for additional loans is maintained by this share. This share of stock carries with it one vote.* None of the later credits entered as "Class C stock" carry with them any voting power whatever, nor do they increase the cooperative's eligibility for loans. Here the Mississippi Chemical Corporation acquired this one "share of Class C stock" in 1956 (A 116), and Coastal Chemical Corporation acquired this one "share of Class C stock" in 1957 (A 97). They were entered on the books of each corporation in the amount of $100. *They are not involved in this suit.*

(2) *Credits entered upon the books of the Bank for Cooperatives representing payments by the taxpayers as "interest override".* These credits were entered in amounts equal to 15 percent of the interest paid during each calendar quarter by the borrower. These are the only credits denominated as "Class C stock" which are involved in this litigation. They do not have any voting power nor do they increase loan eligibility.

(3) *Credits entered upon the books of the Bank for Cooperatives denominated as "patronage refunds"*, being a part of the "net savings" of the Bank. In each of the years involved the amounts thus entered upon the books of the Bank in the amount of $100 a share exceeded the total amount paid by each of the taxpayers as "interest override" (A 99, 97 and A 117, 116). They are not involved in this suit.[2]

(4) *Credits entered upon the books of the Bank for Cooperatives denominated as "allocated surplus"*. These entries constitute the balance of the annual "net savings" of the Bank after entry of the patronage refund credits. When the surplus account of the Bank reaches 25 percent of the total outstanding capital of the Bank, the excess may be converted into "Class C stock". They are not involved in this suit.[3]

Patronage refunds are declared annually in accordance with Section 36(b) of the Farm Credit Act (Br. 51-52)[2]:

> Patronage Refunds.—The patronage refunds of each regional bank for cooperatives shall be paid in class C stock to borrowers, as defined by the Farm Credit Administration for the purposes of this subsection, during the fiscal year for which the refunds are declared. . . . *All patronage refunds shall be paid in the proportion that the amount of interest earned on the*

2. All references such as (Br. 51-52) and (Supp. Br. 1-2) are to Petitioner's original brief and supplement brief. In the brief for the United States the following appears as Note 9 on page 9: "Respondents reported $1 per share of the patronage refunds they received as a reduction of interest expense, but did not include in income the remaining $99 of par value of each share. In the district court, the government contended that the entire par value of each patronage refund share constituted income upon receipt. The district court decided this issue adversely to the government, and the government did not appeal."

3. The government has not contended that the "allocated surplus" constitutes income to the taxpayers.

loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year.

It was stipulated by the parties to these suits as follows (A 96, 114):

> The board of directors of the New Orleans Bank for Cooperatives adopted a resolution on December 15, 1955, wherein it was provided that no certificate evidencing ownership of Class C stock in the bank should be issued (see Exhibit 10-C). *The bank has never issued Class C stock certificates.*

The credits upon the books of the Bank called "Class C stock" have the following attributes (A 93-128):

(1) Neither dividends, interest nor any type of earnings can be paid upon "Class C stock". The so-called patronage refunds in "Class C stock" arise from and are calculated upon interest paid on outstanding loans. *The amount of Class C stock "owned" does not affect the amount of the patronage refunds credited.*

(2) Patronage refunds are credited only to borrowers from the Bank during the year involved. Other holders of "Class C stock" receive no patronage refund.

(3) No certificate of "Class C stock" has ever been issued by the New Orleans Bank for Cooperatives (A 96).

(4) The New Orleans Bank for Cooperatives has *never sold* a single share of "Class C stock" except under the *compulsion* of the statute and regulations (A 242).

(5) The shares of "Class C stock" here involved have no voting power. *The original qualifying share in each case had one vote* and was entered by each taxpayer on the basis of $100.00 par prior

to the period here involved. This one share maintained the cooperative's eligibility for future loans. Such "share" is not involved here. Even though a borrower may own one million shares, it still has only one vote.

(6) The "Class C stock" *may not* be retired or revolved at par until (a) all government Class A stock has been retired, (b) all Class B stock which was issued during or prior to the year in which the subject "Class C stock" was issued has been called for retirement or retired, and (c) all prior "Class C stock" has also been retired. This may be done in the discretion of (i) the Bank, (ii) the Regional Farm Credit Board, *and* (iii) the Federal Farm Credit Board. The contingencies affecting the exercise of such discretion are listed elsewhere (Sec. 42(a) (3), Br. 52).

(7) The stock has no growth potential as (if it is redeemed or revolved) such redemption can only be at par, without interest. *Book value is irrelevant.*

(8) In making a loan the Bank requires *a financial statement from the borrower and if any such statement contains "Class C stock" as an asset, the Bank will not consider it in determining whether to make the loan.* In other words, such "Class C stock" has no value as collateral either to the New Orleans Bank for Cooperatives or otherwise. However, it is subject to a lien as security for any indebtedness of the borrower to the Bank and cannot be transferred until such lien is satisfied (A 238, 246, 243).

(9) Upon foreclosure or upon liquidation of a borrower, all other security is first exhausted. "Class C stock" is used only as a credit up to the unpaid balance. The Bank has never retired any "Class C stock" which remained to the credit of the borrower after liquidation of the debt (A 244).

The record shows that the Bank had never otherwise retired any "Class C stock" and had never revolved or redeemed any such stock (A 244).

(10) A cooperative may not purchase "Class C stock" from another cooperative and use it in lieu of cash to pay the interest override to the New Orleans Bank for Cooperatives (A 245).

(11) A cooperative may not pay an interest override by using in lieu of cash "Class C stock" owned by it (A 246).

When the Class A stock owned by the Government is paid in full (whether from annual net savings of the Bank for Cooperatives or with borrowed money), the only effect is to remove the inhibition against revolving of "Class C stock" because of the existence of such Class A stock. All of the above elements still exist as to "Class C stock" theretofore and thereafter issued. The concurrent exercise of the discretion of the Bank, the Regional Farm Credit Board and the Federal Farm Credit Board as to whether or not the oldest "Class C stock" shall be revolved depends upon many factors, including the following:

(a) The variable amount of funds received from the "interest override" charged to borrowers, which may be fixed between 10% and 25%.

(b) The varying net savings available to the Bank in the "spread" between the interest paid by it on its debentures and the interest charged by it to its borrowers.

(c) The extent that losses may be incurred by the Bank in its operations.

(d) Whether it is decided that the Bank shall retain the funds and expand the financial strength and resources of the Bank, rather than revolve the "Class C stock"

(e) Taxes payable by the Bank after all Class A stock has been redeemed.

(f) The statutory requirement that 20 percent of all current patronage refunds must be paid in cash to its current patrons, applicable when all Class A stock has been redeemed.

(g) The joint and several liability of the New Orleans Bank for Cooperatives with all other Banks for Cooperatives on their consolidated debentures amounting to $382,000,000 in 1961, $429,000,000 in 1962, and $462,000,000 in 1963.[4]

All of this brings us back to a consideration of that which resulted from the payment of cash by the taxpayer as an "interest override", followed by a credit upon the books of the New Orleans Bank for Cooperatives denominated as "Class C stock". It is inescapable that the most which can be said is that such credits are in the nature of revolving fund credits which may never be revolved and are subject to so many varying discretions and contingencies that they are of only nominal value to the borrower which made such payments for the use of money.

4. Under the statute, as well as the "Manual for Banks for Cooperatives" published by the Farm Credit Administration, the New Orleans Bank for Cooperatives is jointly and severally liable for all of the outstanding consolidated debentures of the thirteen Banks for Cooperatives. The auditor's note to the financial statement of the New Orleans Bank for Cooperatives for the year ending June 30, 1963, is as follows (A 103, R 24):

> The unmatured consolidated debentures represent this bank's participation in consolidated debentures outstanding in the total amount of $462,000,000 for which the 13 banks for cooperatives are jointly and severally liable.

The identical note appears on the statement for the fiscal years ending June 30, 1962 and June 30, 1961, with the exception that the then outstanding amount of the unmatured consolidated debentures totaled $429,500,000 and $382,000,000, respectively. See Exhibit 12 to the Stipulation (A 103, R 24). The original exhibit has been filed with the Court. Hence, should any one or more of the other District Banks have financial difficulties, any "redemption" of the Class C stock of the New Orleans Bank for Cooperatives would be indefinitely delayed.

SUMMARY OF ARGUMENT

A.

Section 163(a) of the Internal Revenue Code allows a deduction "for all interest paid or accrued within the taxable year". Section 162(a) allows a deduction for "ordinary and necessary expenses paid or incurred in carrying on any trade or business. . . ."

The cost of voluntary acquisition of a capital asset which has fair market value and is "an income-producing entity" with a useful life extending substantially beyond the close of the taxable year is not deductible. On the other hand, *if a taxpayer is required by contract or by statute to make payments for the use of money which exceed the fair market value of the property or asset received, such excess is deductible.*

"Class C stock" is not an income-producing entity or asset and its fair market value to the taxpayer is nominal. The difference between the excessive price or amount paid ($100.00 per share) and the fair market value of the "Class C stock" ($1.00 per share) is deductible either as interest or as an ordinary and necessary business expense.

A loss suffered upon the sale or the final disposition of a capital asset is not involved. There is involved the nature for tax purposes of the sums paid in excess of the fair market value of Class C stock.

B.

Lincoln[5] *did not involve a determination of the value* of the deposits by the taxpayer into a Secondary Reserve (upon which interest accrued annually). The taxpayer did not raise the question of value in that case, doubt-

5. *Commissioner* v. *Lincoln Savings & Loan Association*, No. 544, October Term, 1970, decided by this Court on June 14, 1971.

less because the availability as cash of the principal (plus accrued annual interest) resulted in "an income-producing entity" having actual substantial cash value to the taxpayer (equivalent to fair market value). The factual differences applicable to the deposits in *Lincoln* (labeled as "prepayment of future insurance premiums") and the interest override payments here (labeled as "investment in Class C stock") are so numerous and significant that the final result reached in *Lincoln* has no application here.

Rather than requiring "a decision for the government here" (Supp. Br. 1), application of the principles announced in *Lincoln* to the facts in these cases will result in an affirmance.

The deposits in *Lincoln* (a) are subject to being withdrawn in cash at face amount plus annual interest, by the taxpayer whenever it decides to terminate its insurance with the FSLIC, (b) bear annual interest "at the rate paid upon obligations of, or guaranteed as to principal and interest by, the United States", (c) are available as cash when required to pay the annual insurance premiums and (d) *the statute mandated repayment with interest upon occurrence of named events.* These deposits necessarily have very substantial value.

C

The statutory label of the payments here as "investments in Class G stock" is not controlling. Neither the specific terminology used, the general overall provisions of the Farm Credit Act nor its legislative history change the true nature of the interest override paid here. The rule is stated in *Lincoln* (Slip Op. 14):

> *. . . so the statutory labels of "prepayment" and "additional premium" contained in § 404 (d) are not controlling.*

D.

As the payments of interest override did not result in the acquisition of an "income-producing asset" having a material fair market value (comparable to the sum paid) which continues in future years, the payments by these taxpayers are governed by the rule of *Lincoln* (Slip Op. 10):

> Further, the presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year.

The ownership of "Class C stock" resulting from these payments resulted in no actual value or material benefit to the taxpayers except the possible revolving of the payments at some unknown and unknowable future time. Repayment is subject to the discretion of (1) the Bank for Cooperatives, (2) the District Farm Credit Board, and (3) the Federal Farm Credit Board. There is no mandatory provision, such as that existing in *Lincoln*, which requires the payments to be revolved upon the occurrence of stated events. *Repayment rests solely within the concurrent discretion of the three above entities.*

Class C stock resulting from these payments has no similarity to capital stock of a private corporation. It differs therefrom in at least eleven particulars, all material for tax purposes, as detailed above.

E.

The rule permitting deduction of excessive price required to be paid for purchase of an interest, right or property in connection with a loan applies here.

Respondents join issue with the position of the petitioner that (Br. 13):

> . . . the price of Class C stock is not excessive; the stock earns a return and also has intrinsic value.

All Class C stock of a Bank for Cooperatives entered during any tax year is identical in nature, value and rights arising therefrom (with the exception of the initial qualifying share not here involved).

Under *Long*[6], *Carpenter*[7], and other cases, and under Treasury Regulations, Section 1.61-5(b) (1) (iv), patronage refunds received by a taxpayer (whether in the form of "stock" or revolving fund credits) were taxable to the recipient at fair market value during the years here involved.

By abandoning its claim that patronage refunds received by these taxpayers in identical years from the identical Bank for Cooperatives had a value of more than $1.00 per share, the Government has admitted that such "Class C stock" credits do not have taxable value. Hence, the entry thereof at $1.00 per share of nominal value attributed to this stock by the taxpayers was proper. The decisions of the Court of Appeals for the Fifth Circuit in these cases, of the Tax Court in *Penn Yan Agway*,[8] and of the District Court in *M.F.A. Central Cooperative*,[9] are correct. The cases at bar should be affirmed.

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6. *Long Poultry Farms* v. *Commissioner*, 249 F.2d 26 (C.A. 4), decided November 8, 1957.

7. *Commissioner* v. *B. A. Carpenter*, 219 F.2d 635 (C.A. 5), decided March 2, 1955.

8. *Penn Yan Agway Cooperative, Inc.* v. *United States*, 417 F.2d 1372.

9. *M.F.A. Central Cooperative* v. *Bookwalter*, 286 F.Supp. 956, reversed, 427 F.2d 1341, petition for writ of certiorari pending, No. 824, this Term.

F.

If this Court finds from the facts existing when this stock was issued as contained in the record in this case, that the "Class C stock" had a fair market value substantially in excess of that found by the District Court and the Court of Appeals this will be a reversal of a finding of the lower courts upon conflicting evidence. *Upon such finding the proper action would be that the case be reversed and remanded for a determination of such value.* This would result in a reduction of the amount deducted by the taxpayers to the extent that such value exceeds $1.00 per share.

The position of the Government that this case should be reversed and rendered is untenable.

ARGUMENT

POINT I

Lincoln Did Not Involve the Question of the Value for Tax Purposes of Deposits Made into the Secondary Reserve Which Earned Interest Annually and Were Available for Use As Cash. Ultimate Determination of Nondeductibility Has No Application Here Because of the Numerous and Significant Factual Differences.

The United States has filed a supplemental brief limited to a discussion of the case of *Commissioner* v. *Lincoln Savings & Loan Association*, No. 544, October Term, 1970, decided by this Court on June 14, 1971. Such brief states, "we believe that the decision in *Lincoln* requires a decision for the government here". For the convenience of the Court we will first discuss the impact of *Lincoln*.

Similarities Between Lincoln and the Case at Bar

Petitioner's supplemental brief states on page 1:

> The issue raised in the two cases, although arising on different facts, is essentially identical.

The opposite is true. The similarities between *Lincoln* and the case at bar are:

(a) The payment was made under a federal statute.

(b) The terminology used in each statute did not reflect the true nature for tax purposes of the respective payments.

(c) There were statutory restrictions upon the transfer of the deposit and of the Class C stock.

(d) Neither payment carried with it voting privileges.

The above similarities are chiefly technical and had no material bearing upon the deductibility of the deposits or the payments.

At the outset we emphasize the application of two findings of this Court in *Lincoln*. First, it is immaterial that the statutory requirement to make "interest override" payments is labeled a requirement "to invest in Class C stock". In *Lincoln* this Court disregarded the statutory designation of the payment (Slip Op. 14):

> We emphasize that just as compulsory accounting is not controlling tax-wise, Old Colony Railroad Co. v. Commissioner, supra, *so the statutory labels of "prepayment" and "additional premium" contained in § 404 (d). are not controlling.*

The amounts paid were entered in the books of the company under the designation "Class C stock". Similar entries were made annually of allocation of patronage refunds as "Class C stock".

The second finding in *Lincoln* which is of particular importance appears on page 10 of the Slip Opinion:

> Further, the presence of an ensuing benefit that may have some future aspect is not controlling; *many expenses concededly deductible have prospective effect beyond the taxable year.*

As pointed out below, the presence of any ensuing future benefit is so illusory in the case of the payment of the "interest override" that it necessarily falls within the above rule. The factual differences detailed below clearly demonstrate the reason that a different conclusion was reached in *Lincoln* from that reached in this case by the Court of Appeals for the Fifth Circuit, in *Penn Yan Agway* by the Court of Claims, and in *M.F.A. Central Cooperatives* by the District Court.

Differences Between Deposits into the Secondary Reserve in Lincoln and Payments of the Interest Override Here

In Lincoln the deposits made into the Secondary Reserve in truth and in fact resulted in an income-producing asset. One of the material bases of the finding in *Lincoln* was the mandate of Section 404(e) of the Federal Home Loan Bank Act that there be credited to the Secondary Reserve annually "a return on the outstanding balances of the Secondary Reserve during such calendar year" at a rate equal to the average annual return to the Corporation (Federal Savings & Loan Insurance Corporation—"FSLIC") "on investments held by the Corporation in obligations of, or guaranteed as to principal and interest by, the United States". This major factor was recognized by the Court in *Lincoln* (Slip Op. 11):

> The statutorily required annual credit from FSLIC's earnings to the institution's share of the Secondary Reserve. The share thus is an *income-producing entity*, and the income inures for the benefit of the insured institution.

In this connection we quote from the brief of the United States in *Lincoln* (page 18):

> Moreover, respondent's share of the Secondary Reserve is itself earning a return ranging from 3.15 to 4.23% annually (R 35-38, 52).

We emphasize that the "interest override" payments never earn any return or income of any nature. To the contrary, the "Class C stock" of the NOBC bears no interest, may receive no dividends, and, if the Bank, in its discretion, decides to revolve or redeem the "stock", the only amount received would be the principal sum originally paid by the borrower many years before as "interest override".

In Lincoln the taxpayer had the discretion to require at any time that the FSLIC refund the principal of all deposits plus annual interest. This major factor affecting the taxable nature of the deposits was recognized in *Lincoln* (Slip Op. 10-11) as follows:

> The prospective refund, and in cash at that, of the institution's pro rata share *upon termination of its insured status* or upon receivership or liquidation or when the Primary Reserve alone reaches the suspension level.

In *Lincoln* this Court brushed aside the taxpayer's argument that the termination of insurance would be an undesirable business decision (Slip Op. 12-13). The legal right is fixed by the statute. Throughout the United States the deposits of many savings and loan associations are insured by companies other than the FSLIC. The writer of this brief has represented one such insuring corporation.

In the case at bar the taxpayers have no control whatsoever over the amounts paid as "interest override". Whether the resulting "Class C stock" will be revolved or refunded without interest lies solely within the discretion of the Bank. Even though the taxpayers here were to obtain their financing from some financial institution other than the Bank for Cooperatives and thereby terminate their status as borrowers (an action considered and investigated by them several times), they cannot require repayment of the sums paid as "interest override" and entered upon the books of the Bank as "Class C stock". The material factor is that the taxpayers here have no legal right to require repayment in cash at any time or under any circumstances. *Repayment is solely within the discretion of the directors of the Bank for Cooperatives.*

In Lincoln the statute mandated the refund in cash or the use as cash of the principal and accrued interest of all deposits upon the occurrence of events described in the statute. The FSLIC has no discretion. On the contrary, the directors of the Bank for Cooperatives may exercise their unlimited discretion in determining when and whether or not the amounts paid as "interest override" shall be repaid by redemption of the "Class C stock" upon occurrence of events described in the statute. Whether or not such sums will be credited to the borrower if it goes into liquidation or receivership is also within the sole discretion of the directors of the Bank.

Each applicable section and paragraph of the Federal Home Loan Bank Act provides that under the described circumstances the FSLIC "*shall* pay in cash", or the payments "*shall* be used" as cash, or equivalent mandatory words.

The opposite is true of the provisions of the Farm Credit Act applicable to Banks for Cooperatives. All of the provisions of the Farm Credit Act having to do with use of credited "Class C stock" in case of liquidation or receivership and in the case of retirement or revolving thereof (12 U.S.C. 1134, Sections 36 and 42 of the Farm Credit Act, as amended, see pages 49 through 58 of the brief for the United States) provide that, "The Bank *may* . . . retire and cancel any capital stock or allocated surplus and contingent reserve or other equity interest", or that "Class C stock also *may* be *retired at par* by calling the oldest outstanding Class C stock".

Every action which may be taken by the Bank for Cooperatives resulting in financial benefit to the borrower lies solely within the discretion of the directors of the Bank, exercised in accordance with rules of the Farm Credit Administration.

The mandate to use as cash or to refund in cash the FSLIC deposits, upon the occurrence of stated events, cannot be equated with the discretionary use or refund of the "interest override" payments by the Banks for Cooperatives, upon the occurrence of stated events.

No Question Was Raised or Decided in Lincoln Concerning the Fair Market Value of Its Deposits in the Secondary Reserve

The supplemental brief of the petitioner states, "Our position is that the payments in dispute result in the creation of an asset having a useful life extending substantially beyond the close of the taxable year", and that, "Respondents' interest in the Bank is . . . 'an income-producing entity' in respondents' hands" (pages 2-3).

This position begs the issue in the case at bar. The present question (although falling within the ambit of what is or is not a capital asset and what is or is not deductible as payment of interest or an ordinary and necessary business expense) actually involves solely the value of the entries of "Class C stock" made by the Bank upon the payment of the "interest override". The minor prospective effect of some possible ensuing benefit beyond the taxable year was negated in *Lincoln* as a factor determining whether or not these payments are deductible. As elsewhere demonstrated, this "Class C stock" never has and never will produce any income. Redemption may never occur.

The true issue in the present case and the correct determination thereof (demonstrating that *Lincoln* does not adversely impinge upon this case) can best be clarified by quoting from the opinion of the Court of Appeals for the Fifth Circuit (A 354-356):

In the present case, considering the nature of the Class C stock and the testimony as to its value adduced in the district court, that court was not clearly erroneous in determining that the Class C shares had no fair market value and no more than a nominal value to the taxpayers. . . .

Neither did taxpayers acquire an asset of continuing value, though less than the purchase price; *the Class C shares were of no appreciable value to the taxpayers.* It is at odds with the incisive realism required in determining the tax consequences of ambiguous transactions to treat these purchases as "investments"; they were something else. (27)

We agree with the trial court and with the Court of Claims in *Penn Yan,* that the purchase price of the Class C stock (in excess of the nominal value assigned it by taxpayers) is deductible as interest in the year of purchase. Section 163(a) of the Code provides, "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The interest which is deductible under this section is defined as, "the amount one has contracted to pay for the use of borrowed money." As we have noted the Class C stock was without practical value to the taxpayers. Their only reason for acquiring the shares was as a prerequisite for continued borrowing from the Bank. . . .

Note 27—Our decision on this point appears to be at odds with that of the Eighth Circuit in *M.F.A. Central Cooperative* v. *Bookwalter,* 427 F.2d 1341 (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970]. Insofar as that court's decision is not attributable to the difference in value of the St. Louis shares, we are simply unable to agree. If we concluded, as did the Eighth Circuit, that the "interest override" payments were made *to acquire Class C shares as capital assets,* we would agree that recognition of gain or loss must ordinarily await realization through sale

or exchange. However, we agree with the court below, that, *for tax purposes, the bulk of these payments were not actually made to acquire an asset.*

It is clear and indisputable that no person in his right mind would invest in "Class C stock" at $100 per share to acquire the same as a capital asset. Whether or not the "stock" ever has *any* value depends upon the policies, actions and discretion of the directors of the Bank for Cooperatives. No income can be earned. No dividends can be declared. No interest can be accrued or paid. The principal may be refunded at some indefinite future time.

After studying the above differences in the payments made in *Lincoln* and the payments made here, we can see why the taxpayer in *Lincoln* failed to raise the question of value. Payments made and deposited in a Secondary Reserve (a) are subject to being withdrawn by the taxpayer whenever it may decide to terminate its insurance with the FSLIC, (b) bear annual interest "at the rate paid upon obligations, of, or guaranteed as to principal and interest by, the United States", (c) are available for use to pay the annual insurance premiums when required, and (d) will be repaid *with interest* unless the FSLIC falls into financial difficulties. These deposits must necessarily have very substantial value, indeed a value approaching the principal amount thereof.

POINT II

"Class C Stock" Had No Fair Market Value at the Time It Was Credited to the Taxpayers Either As "Investment C Stock (Interest Override)" or "Patronage Refund—Class C Stock".

The books of the New Orleans Bank for Cooperatives showed, separately as to each of these taxpayers, an entry of the purchase of a "qualifying share" of Class C stock

at $100.00. Each year thereafter three entries were made in such books, i.e., "investment in C stock (interest override)", "patronage refund—C stock" and "patronage refund—allocated surplus" (A 123, 124). It is clear from the evidence that these credits thus entered upon the books of the Bank as Class C stock—"interest override" have no fair market value nor do they have any actual cash value to the taxpayer.

In *Stiles* v. *Commissioner of Internal Revenue*, 69 F.2d 951 (C.A. 5), the Court said:

> The 1921 Revenue Act (42 Stat. 230), § 202(c), in the same connection uses the term "readily realizable market value". The change is significant. Under the 1926 act and subsequent acts a *reasonable interpretation of the term "fair market value" is that it is equivalent to actual cash value.* In other words, the value of the property in money to one who wishes to sell to a purchaser who wishes to buy.

The something known as "Class C stock" has no exchange value. This rule is stated by the Court of Appeals of the Tenth Circuit in *Walls* v. *Commissioner of Internal Revenue*, 60 F.2d 347:

> In Eisner v. Macomber, 252 U.S. 189, 207, 40 S.Ct. 189, 64 L.Ed. 521, 9 A.L.R. 1570, the court, in determining whether a stock dividend was subject to tax as income, emphasized that *income was something of "exchangeable value"* proceeding from the property (capital). The phrase *"fair market value"* was used in the Treasury Regulations to mean that, *if a person received "something" for his services for which there was no market and which therefore had no exchange value, that "something" could not be considered as income.* . . . Therefore it did not have a value realizable in money's worth. . . . From the above cases it appears that the term *"fair market value"* was used in the income tax statutes to mean exchangeable value,

> for, *if a person could not realize a sum of money from the sale of property received by him, it was not proper to consider it as profit.*

The evidence is clear that "*Class C stock*" *will not change hands between a willing buyer and a willing seller* for any amount presently realizable in cash, neither party being under any compulsion to buy or sell. The applicable rule is stated in *Willow Terrace Development Company* v. *Commissioner of Internal Revenue*, 345 F.2d 933 (1965):

> The standard for determining *fair market value* under § 1001 is well established. It is the *price at which property will change hands* between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the facts. French Dry Cleaning Co. v. Commissioner of Internal Revenue, 5 Cir., 1934, 72 F.2d 167.

The fact that the cooperatives paid par for the "Class C stock" is no evidence of value because it was done under compulsion of the statutes, regulations and loan documents. *The Bank has never sold a single share of stock to any cooperative other than under compulsion of the statutory requirement* (A 242). The rule applicable to such "sales" was stated by the Court of Appeals of the Third Circuit in *Hazeltine Corporation* v. *Commissioner of Internal Revenue*, 89 F.2d 513, 519, as follows:

> The primary evidence of the fair market value of corporate stock is *what willing purchasers pay to willing sellers on the open market*, even though the assets of the corporation do not reflect such values. Appeal of Edwin M. Brown, 1 B.T.A. 502; Commissioner v. Robertson, (C.C.A.) 75 F.2d 540, certiorari denied 295 U.S. 763, 55 S.Ct. 922, 79 L.Ed. 1705. *It is true that if market sales are made under peculiar and unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market, they may not furnish evidence of fair market value.* Heiner v. Crosby, (C.C.A.) 24 F.2d 191.

See also the decision of the Court of Appeals of the Third Circuit in *Collector of Internal Revenue* v. *Crosby*, 24 F.2d 191, holding:

> The fact of sales, in itself and without regard to the circumstances under which the sales were made, does not conclusively establish either statutory fair market price or value. *Sales made under peculiar and unusual circumstances*, such as sales of small lots, forced sales, and sales in a restricted market, may neither signify a fair market price or value, nor serve as the basis on which to determine the amount of gain derived from the sale.

The great majority of the testimony adduced before the District Judge had to do with a claim by the United States that Class C stock of the New Orleans Bank for Cooperatives had a fair market value. A Mr. O'Farrell testified at length as an expert witness for the United States (A 291-342). Mr. Verlander, President of the New Orleans Bank for Cooperatives, and a Mr. Mounger testified at length on this issue for the taxpayers (A 225-262, 262-274). The evidence of Mr. O'Farrell was destroyed on cross-examination. We will not burden this brief with a discussion thereof for the reason that such evidence has been ignored and its effect abandoned on this appeal. The conflict in this evidence was resolved by the District Judge in favor of the taxpayers.

POINT III

Nothing of Taxable Value Was Received Upon the Payment of the "Interest Override" (As Demonstrated by the Tax Status of Patronage Refunds Paid in Class C Stock). The Taxpayers Were Entitled to Deduct the Amounts Paid by Them in Excess of the Nominal Value of $1.00 Per Share.

During the years involved in this suit (1961, 1962 and 1963 as to Mississippi Chemical Corporation and 1958 through 1963 as to Coastal Chemical Corporation), the

valuation for tax purposes of capital stock and similar certificates issued by a cooperative as partonage refunds is stated in Treasury Regulations, Section 1.61-5(b) (iii) and (iv) as follows:

> (iii) If the allocation is in the form of revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or similar documents, *the amount of the fair market value of such document at the time of its receipt by the patron.* . . . However, for purposes of this subdivision, *any document which is payable only in the discretion of the cooperative association,* or which is otherwise subject to conditions beyond the control of the patron, *shall be considered not to have any fair market value* at the time of its receipt by the patron, *unless it is clearly established to the contrary.*
>
> (iv) If the allocation is in the form of capital stock, *the amount of the fair market value, if any,* of such stock at the time of its receipt by the patron.

The above provisions were embodied in the regulation on December 2, 1959, by issuance of T. D. 6428. Thereby the Treasury Department conformed to the decision of the Court of Appeals for the Fifth Circuit in *Commissioner* v. *B. A. Carpenter,* 219 F.2d 635, decided March 2, 1955, and the decision of the Court of Appeals for the Fourth Circuit in *Long Poultry Farms* v. *Commissioner,* 249 F.2d 26, decided November 8, 1957.

It follows that if "certificates of indebtedness . . . or other similar documents" issued as patronage refunds which are payable only in the discretion of the Bank for Cooperatives "shall be considered not to have any fair market value at the time of receipt by the patron, unless it is clearly established to the contrary", the "Class C stock" issued upon payment of "interest override" by the identical Bank at the identical time to the identical tax-

payer under the identical statute and regulations and subject to the identical discretions necessarily has no greater fair market value for tax purposes than "Class C stock" issued as patronage refunds. Both the District Court and the Court of Appeals determined that the evidence in this case established that at the time of its issuance this stock had no fair market value but only nominal value.

The leading case applicable to the question before the Court is *Carpenter*, decided by the Court of Appeals for the Fifth Circuit on March 2, 1955. In that case the Court held:

> These certificates were *redeemable only in the sole discretion of the directors of the cooperative, were non-interest-bearing, were junior to all debts of the cooperative, and could be redeemed only upon written approval of the Columbia Land Bank*, the mortgagee of the coperative . . .
>
> It is abundantly clear that the taxpayer's receipt of revolving fund certificates was not equivalent of the actual receipts of cash, because the certificates had no fair market value. Furthermore, it is obvious that the funds withheld by the cooperative were not subject to the demand of the respondent. The respondent could control neither the amount of the funds that he would ultimately receive nor the time at which he might receive them. *These matters were left to the discretion of the cooperative's directors*, and even the directors could not pay off the certificates without written consent of the mortgagee. *Therefore, the respondent never actually or constructively received or had any right to receive anything but the certificates. . . . We are of the opinion that the certificates, when issued to the respondent, did not constitute income.*

The entries of "Class C stock" (to use the words of *Carpenter*) "were redeemable only in the sole discretion of the directors of the cooperative [Bank], were non-

interest-bearing, were junior to all debts of the cooperative, and *could be redeemed only upon written approval" of the Farm Credit Administration.* Although it is hardly necessary to go further, we quote Chief Judge Parker of the Fourth Circuit in *Long Poultry Farms* (which cited *Carpenter* with approval), holding as follows:

> On these facts, as to which there is no dispute, we think it clear that taxpayer did not receive income as the result of the credit allotted, nor did it become intitled to receive anything which could properly be accrued as income. *All that it received was a conditional credit on the books of the cooperative, a credit which was subject to diminution if the cooperative sustained losses, was subordinated to the payment of the cooperative's debts, was not to be paid until all prior holders of credits over a nine year period had been paid in full and was to be paid only if and when the directors of the cooperative should so decide.* It is argued that under implied agreement arising out of the provisions of the bylaws taxpayer in effect received in cash the amount of the credit and reinvested it in the revolving fund of the cooperative; but this is simply to exalt fiction and ignore reality. As said by this Court in Home Furniture Co. v. Com'r, 4 Cir., 168 F.2d 313, "Economic realities, not legal formalities, determine tax consequences." The truth is that the taxpayer never received anything except a credit on the cooperative's books which did not entitle it to receive anything except upon the conditions above enumerated, *and only then if the directors of the cooperative should so determine.* . . .

The "Class C stock" of the New Orleans Bank for Cooperatives, at the time it was acquired by the plaintiff, had no "fair market value", "actual cash value" or "exchangeable value". The amount which plaintiffs paid for such stock was paid for one reason only—in order to permit plaintiffs to borrow money from the Bank. In return for such payment, plaintiff received nothing of taxable

value. It obtained the use of money. Accordingly, such payment is deductible as interest under I.R.C. § 163(a):

> Sec. 163. INTEREST.
>
> (a) General Rule.—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

In the alternative, such payment is deductible as an ordinary and necessary business expense under I.R.C. § 162(a):

> Sec. 162. TRADE OR BUSINESS EXPENSES.
>
> (a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . .

It is clear that "interest", as that term is used in the Internal Revenue Code, is "the amount which one has contracted to pay for the use of borrowed money", *Old Colony R. Co.* v. *Commissioner of Internal Revenue*, 284 U.S. 552, 560 (1932), or "compensation for the use or forbearance of money", *Deputy* v. *duPont*, 308 U.S. 488, 498 (1940). The courts have consistently held that amounts which are *in fact* paid for the use of money constitute interest, though *in form* such amounts may appear to be something other than interest and though the parties may not have called them interest. In *Oil City Motor Co.* v. *C.I.T. Corporation*, 76 F.2d 589, 591, for example, the Court of Appeals for the Tenth Circuit stated:

> . . . The familiar doctrine is invoked that if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value *or to purchase property from him at an excessive price, the difference represents interest* and will be

> taken into account in determining whether the transaction is usurious. That principle is firmly rooted and we are in accord with it.

In a later case, *Memorial Gardens of Wasatch* v. *Everett Vinson & Assoc.*, 264 F.2d 282 (C.A. 10, 1959), the same court, after quoting this statement, said at p. 285:

> No further authority need be cited in support of this universally accepted principle.

This principle—that substance rather than form will determine whether a payment is interest—is firmly embodied in the tax law. In *Wiggin Terminals, Inc.* v. *United States*, 36 F.2d 893 (C.A. 1, 1929), the taxpayer borrowed money and agreed to pay the lender 6 percent plus a 100 percent "bonus". This result was accomplished, presumably in order to avoid the usury laws, by issuing stock to the lender for a temporary period and paying dividends on such stock equal to the bonus agreed upon. In holding that such dividends were deductible as interest in computing the borrower's taxable income, the court stated at p. 898:

> If it be shown that dividends paid are, according to the intent of the parties, in fact interest, and the stock on which the dividends are paid is merely held by the creditor as security, it makes no difference what the reason was for paying in that form. *The courts look to the real character of the payment, and construe the statute liberally in favor of the taxpayer.*

The Tax Court applied the same reasoning in holding that an amount paid for the use of money was deductible as interest even though designated "rent discount" by the parties, *Court Holding Co.*, 2 T.C. 531 (1943), rev'd on other grounds, 143 F.2d 823 (C.A. 5, 1944), and again in *L-R Heat Treating Co.*, 28 T.C. 894 (1957), where a premium paid to the lender was held deductible as interest

in spite of the fact that the parties did not call the premium interest and that the borrower did not treat it as interest on its books.

POINT IV

The Government Admitted in the Court of Appeals That "Class C Stock" Issued Upon Payment of the "Interest Override" Was Not an Income-Producing Entity and Did Not Appeal from the District Court's Decision That "Class C Stock" Issued As Patronage Refunds Had No Value for Tax Purposes, I.E., No Fair Market Value

We are amazed by the position taken by the petitioner on pages 22 through 28 of its original brief and pages 3 and 4 of its supplemental brief. On page 24 of the petitioner's original brief the following statement is made:

> When a borrower cooperative purchases Class C stock, thus fulfilling its obligation under its loan agreement (R 127), *it becomes entitled to share in the distribution of the Bank's net savings at the end of the fiscal year.*

On the same page this conclusion is applied to the Mississippi Chemical Corporation and upon assumption of various possible "retirement periods", it is stated to this Court that:

> This represents an average annual return on its investment of 6.16 percent. If the redemption period were ten years, the average annual return would be 9.38 percent; if it were as long as 30 years, the return would be 3.03 percent.

On pages 3 and 4 of its supplemental brief petitioner states that the Class C stock received upon payment of the interest override "is an income-producing entity", referring to pages 23-24 of the original brief.

We have examined briefs filed by the United States in *Penn Yan Agway*, in *M.F.A. Central Cooperative* and

in the District Court and the Court of Appeals in the case at bar. *The United States has never before advanced the specious and untenable argument summarized in the above quotations and detailed on pages 23 to 28 of its original brief and pages 3 and 4 of its supplemental brief.*

In the brief filed for the United States in the Court Appeals of the Fifth Circuit, it time and time again recognized that "Class C Stock" is not an income-producing entity, pays no dividends, bears no interest and receives no return. The attributes of this stock are detailed on pages 5 and 6 of such brief as follows:

> The taxpayers purchased Class C stock in the Bank at $100 per share. As cooperative borrowers, they were required to invest in the Bank's stock. The stock did not pay cash dividends and could be transferred only to other cooperatives with the Bank's permission. The owners of Class C stock did have voting rights in the Bank and were entitled to a number of long-term services by virtue of their ownership interests. The precise point at which the Class C stock would be redeemed was not definite. Nevertheless, it was apparent that it would be redeemed at its full par value of $100 per share.

After discussing the format of the Farm Credit Act of 1955, the following statement is made on page 20 of such brief:

> The result was that taxpayers herein obtained Class C stock certificates which (a) *paid no dividends,* (b) were based upon the "one man-one vote" concept regardless of the number of shares owned, (c) *did not have a "market" in the usual sense,* (d) were to be retired seriatim on a revolving-fund basis, and, most importantly (e) served as a basis of the capital structure of the Banks without which they could not function.

This position is reaffirmed and explained by the Government on page 21 and page 24 of such brief as follows:

> P.21—As we have shown, this type of capitalization, although peculiar to ordinary corporations, is common to cooperatives. The restrictions on transfers of the stock, *and the fact that there were no cash dividends,* are not unusual in these circumstances and are not regugnant to its capital status. The substance of the stock affirms that status.
>
> P.24—*In truth, because of the special characteristics of the stock, there is no reasonable and determinable market value which can be assigned to it.* As one authority puts it (Packel, supra, p. 234):
>
> The circumstances surrounding the issuance of revolving fund certificates are often such that *no particular market value can be ascribed to the certificate even though it refers to a sum certain.*

Evidently, at this appellate level, the Government has realized that if it recognizes the facts which exist and which it admitted in the District Court and the Court of Appeals for the Fifth Circuit, in the Tax Court in *Penn Yan Agway* and in the District Court and the Court of Appeals for the Eighth Circuit in *M.F.A. Central Cooperative,* the cases at bar will be affirmed. Hence, it has completely reversed its position and now says that patronage refunds (paid from the entire net savings of the Bank for Cooperatives in that proportion which the interest paid by a borrower bears to the total interest received) constitute a return upon the "interest override".

No share of "Class C stock" involved in this litigation carried with it voting rights, no share bore interest, received dividends, or any earning or return, no share could be used as collateral for any loan nor for any other beneficial purpose (and had no fair market value even for

sale to entities to which it might be transferred). Its only attribute is the possibility that, subject to all of the matters set forth above, at some future date (which might be 14 years, 20 years, 30 years, or 12 years), the holder of the stock may receive the number of dollars paid the Bank many years before.

Nevertheless, this stock is erroneously described in petitioner's brief as:

> "an asset—an item of value—having a useful life extending substantially beyond the close of the taxable year" (Br. 9);
>
> "an income-producing asset providing benefits in future years" (Br. 11);
>
> "stock [which] earns a return and also has intrinsic value" (Br. 13);
>
> "provides purchasers with long-term benefits in the form of a return on their investment" (Br. 23);
>
> the holder "becomes entitled to share in the distribution of the bank's net savings at the end of the fiscal year" (Br. 24); and
>
> "investment (which) grows in value through the mere passage of time, and thus produces a return to the stockholder" (Br. 27);
>
> "purchasers of Class C stock have the opportunity to earn a return on the funds they invest" (Br. 28);
>
> a stock which "like the stock of an ordinary corporation has continuing value" (Br. 34);
>
> a stock which "bears a return and also has an intrinsic value" (Br. 38);
>
> A capital asset which "is 'an income-producing entity' (slip op. 11) in respondents hands" (Sup. Br. 3)—the reference is to the slip opinion in *Lincoln*.

A simple illustration suffices to destroy the tortured argument of petitioner upon which the above conclusions rest. Let us assume that Cooperative A has accumulated Class C stock with a total par value of $100,000 and Cooperative B has accumulated Class C stock with a total par value of $25,000. During the succeeding year, Cooperative A borrows $30,000 from the Bank and Cooperative B borrows $60,000 from the Bank. As the interest paid by Cooperative A is one-half of the interest paid by Cooperative B, the patronage refunds and allocated surplus received by Cooperative A for that year would be one-half of the patronage refunds and allocated surplus received by Cooperative B for that year.

Let us assume that Cooperative X owns one qualifying share of Class C stock in the Bank (the year being its first year as a borrower) and Cooperative Y has accumulated Class C stock in the Bank during prior years with a total par value of $150,000. Cooperatives X and Y each borrow the same amount from the Bank during the year. Each will receive a patronage refund and allocated surplus in an identical amount. Neither the ownership of Class C stock during prior years nor the "purchase" of Class C stock by payment of the "interest override" results in any income, dividend, or earning to the borrower. This is received solely because of the contractual interest paid by the cooperative during the year "in the proportion that the amount of interest earned on loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year".

Petitioner has realized that the decision of the Court of Appeals below must be affirmed unless this Court holds that these payments of interest override resulted in the acquisition of an income-producing capital asset or "an income-producing entity", having a substantial continuing

value for which the taxpayers were not required to pay an excessive price. Thus the real issue here is the value of the shares of "Class C stock" purchased under the compulsion of the federal statute.

We close this phase of the argument by referring to page 38 of petitioner's brief where it cites *Penn Yan Agway,* (417 F.2d at 1379) opinions by the Tenth Circuit (*Oil City Motor Co.* v. *C.I.T. Corp.*, 76 F.2d 589, 591, and *Memorial Gardens of Wasatch, Inc.* v. *Everett Vinson & Associates,* 264 F.2d 282, 285), and then quotes from *Memorial Gardens* the well-recognized rule:

> . . . if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest and will be taken into account in determining whether the transaction is usurious. * * *

The petitioner then, brushing aside this principle of law which actually requires, of itself, the affirmance of these cases, says (Br. 38):

> But this principle has no application here because the Banks for Cooperatives *do not require their members to "purchase property from* * * * [*them*] *at an excessive price."*

This squarely raises the basic issue of value. It is an indirect admission that if the taxpayers were required to "purchase" the Class C stock" for a price in excess of its fair market value, such excess represents interest and is deductible.

In closing we will not attempt to comment upon numerous statements in petitioner's brief which are based upon matters occurring not only long after 1963, the last year involved in these cases, but long after the trial in

the District Court. It goes without saying that statements in the brief concerning what the writer may have been told by the Farm Credit Administration, particularly as to matters occurring after 1963, are wholly incompetent and immaterial. The status and value of the "Class C stock" here involved can only be determined as of the date it was issued.

The Court will note (A 93-123) that all facts contained in the Stipulation and also that all evidence contained in the Appendix have to do with matters occurring during or prior to the year 1963. We will point out, however, that the evidence to which reference is made in Note 17 on page 22 of petitioner's brief has been misunderstood. The transfers to which reference is made (A 107, 275-291) do not reflect any consideration paid by the transferee, doubtless due to the fact that such transfer was a part of a broad transaction between the parties. The only transfer as to which consideration is recited is that from Associated Cooperatives to Mississippi Federated Cooperatives (A 276-291). This was an integral part of a complicated transaction between two related cooperatives. Mr. McNeil was the manager of M.F.C. and a director in Associated Cooperatives (A 277). There was involved the balancing of indebtednesses between the cooperatives and the $12,000 mentioned simply was one of the belated acts balancing accounts between them.

Further, the statement that "the Bank also redeemed Class C stock for full book value on ten occasions during the years in issue" (A. 130, 133, 241; A 45-46, 238-239, 248-249) is a misunderstanding of the facts reflected in the Appendix. The transactions to which reference is made were chiefly those in which there was a foreclosure or liquidation and the book value of the Class C stock was credited to the balance due on the indebtedness but no

redemption was had of any remaining Class C stock. In other words, Class C stock was not retired or redeemed with the par value or book value thereof being paid to the stockholder. These transactions amounted to a book entry crediting the par value or book value of the stock to the indebtedness up to but not to exceed the balance unpaid.

The New Orleans Bank for Cooperatives had never revolved or redeemed any "Class C stock" at the time of the trial of these cases on November 7, 1968 (A 244).

CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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